Massachusetts Electric
A National Grid Company

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Counsel

July 29, 2003

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: D.T.E. 03-67

Dear Secretary Cottrell:

On behalf of Massachusetts Electric Company and Nantucket Electric Company (collectively "Mass. Electric" or "Company"), I am responding to the Attorney General's comments regarding a contract amendment the Company has entered into with one of its standard offer suppliers ("Amendment").

The Attorney General states that the Federal Energy Regulatory Commission ("FERC"), and not the Department, has jurisdiction over the Amendment. The Attorney General also states that Mass. Electric's request to recover "additional standard offer costs" violates the terms of the Eastern Edison Electric Restructuring Settlement Agreement. The Attorney General recommends that the Department conduct a prudence inquiry of the underlying contract. The Attorney General also recommends that the Department deny Mass. Electric's request for confidential treatment. Mass. Electric will address each of these arguments in this letter.

First, the Attorney General argues that FERC, and not the Department, has jurisdiction over this matter. The Attorney General is correct that FERC approved the underlying wholesale standard offer contracts, and that the Department exempted them from further review and approval under Mass. Gen. Laws c. 164, § 94A in its acceptance of a stipulation been Eastern Edison, Montaup Electric Company, and the Attorney General in D.T.E. 97-105. Under current FERC rules, the supplier has the responsibility of notifying FERC of this Amendment, and no further action is required by FERC for the Amendment to be effective. Therefore, the Attorney General is correct that FERC has jurisdiction over the underlying agreements.

Case law is well established that the Department must allow a retail electric company to pass on the underlying wholesale costs that it incurs pursuant to FERC regulated rates and contracts. Eastern Edison Company v. Department of Public Utilities, 338 Mass. 292446 N.E. 2d 684 (1983); Narragansett Electric Company v. Burke, 119 R.I.

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559, 381 A.2d 1358 (1977), *cert. denied,* 435 U.S. 972 (1978). Therefore, normally the Department would be pre-empted from disallowing Mass. Electric from recovering the costs that it incurs under the Amendment. However, the Company has conditioned the effectiveness of the Amendment on Department approval to avoid giving rise to jurisdictional conflicts. Simply stated, under our filing, if the Amendment is not consistent with Department policy, the Department is free to reject it.

The Attorney General's second argument, that Mass. Electric's proposal violates the terms of the Eastern Edison Electric Restructuring Settlement Agreement, is mistaken. At the time of settlement agreement, the restructured wholesale power market was still under development. In December 1996, NEPOOL filed a comprehensive restructuring proposal with FERC. At that time, NEPOOL members believed there was relatively little congestion in New England. The proposal recognized the need to address potential congestion costs and the NEPOOL Participants agreed conceptually to a methodology for assigning congestion costs to suppliers of load but deferred the details to later development. Faced with the need to address other issues associated with its restructuring, NEPOOL did not agree in 1997 on a methodology for assigning congestion costs to suppliers of load. In October 1997, NEPOOL proposed an interim mechanism for assigning congestion costs. Under this mechanism, the costs would be paid as a transmission charged and socialized throughout New England. This "interim" allocation method was only supposed to be in effect through the end of 1999, thereafter, NEPOOL planned to assign the costs under market operation rules to be adopted later. In March 1999, NEPOOL submitted a preliminary proposal for a congestion management system to FERC. NEPOOL was, however, unable to agree on a final congestion management system and the interim allocation method was extended several times thereafter. Thus, to the extent the Company incurred costs for congestion, customers paid for these costs through the transmission charge. It was not until the implementation of Standard Market Design ("SMD") by the Independent System Operator – New England ("ISO-NE") on March 1, 2003, that a change in the way congestion costs were allocated was implemented.

The Company should not be denied recovery of costs reasonably incurred under a wholesale power supply contract, as the Attorney General recommends on page 5, because of fundamental changes in the operation of the wholesale power markets as a result of the implementation of SMD, which has caused an ambiguity in the contracts that Mass. Electric is seeking to amend. The Amendment eliminates Mass Electric's and the supplier's dispute over the allocation of costs under the contract. It was appropriate for customers to pay for congestion before SMD, and it remains appropriate for them to pay the increased contract rate under the circumstances.[1] The Amendment significantly mitigates the uncertainty and exposure to these costs, which is very beneficial to customers. The Company and the supplier have been treating congestion related expenses as set forth in the Amendment since March. During the period March – July 20,

[1] Following the Attorney General's logic that these costs are not articulated anywhere in the Eastern Edison Restructuring Settlement, Mass. Electric is entitled to collect them as an Exogenous Factor either as a reclassification or costs or as a rule change, pursuant to its long term rate plan settlement in D.T.E. 99-47.

2003, the Company paid approximately $1.2 million in congestion related expenses pursuant to the Amendment. The Company calculates that the supplier would have billed the Company approximately $4.6 million to $6.4 million absent the Amendment.

There is no merit to the Attorney General's third suggestion that the Department conduct a prudence inquiry into the wholesale standard offer contracts. It is not clear how the Attorney General can think that these contracts are both outside of the Department's jurisdiction (Attorney General's comments pp. 2-4) and that they should be the subject of a prudence inquiry (Attorney General's comments p. 5). As the Attorney General notes, the Department exempted the underlying wholesale standard offer contracts from further review and approval under Mass. Gen. Laws c. 164, § 94A in its acceptance of a stipulation been Eastern Edison, Montaup Electric Company, and the Attorney General in D.T.E. 97-105. The Department can not now conduct a prudence inquiry into those same contracts it exempted from further review. In any event, it is clear that the underlying contracts were less expensive than the market price, as the attached chart shows. Moreover, as discussed above, the Amendment is also less expensive than the market price.

Finally, the Attorney General recommends that the Department deny the Company's request for confidential treatment. The Company notes that the Attorney General's entire filing on this matter violates the terms of confidentiality agreements it entered into covering the Company's filing. The Attorney General made public a great deal of the information that the Company and its supplier wished to keep confidential. The Company notes that the confidentiality agreement provides a remedy for the Attorney General, should he wish to disclose information that the Company has given to him with a request for confidential treatment. The Attorney General did not follow this procedure. Nevertheless, for the reasons set forth in the Company's motion, it is appropriate that what information has not yet been put into the public arena remain confidential.

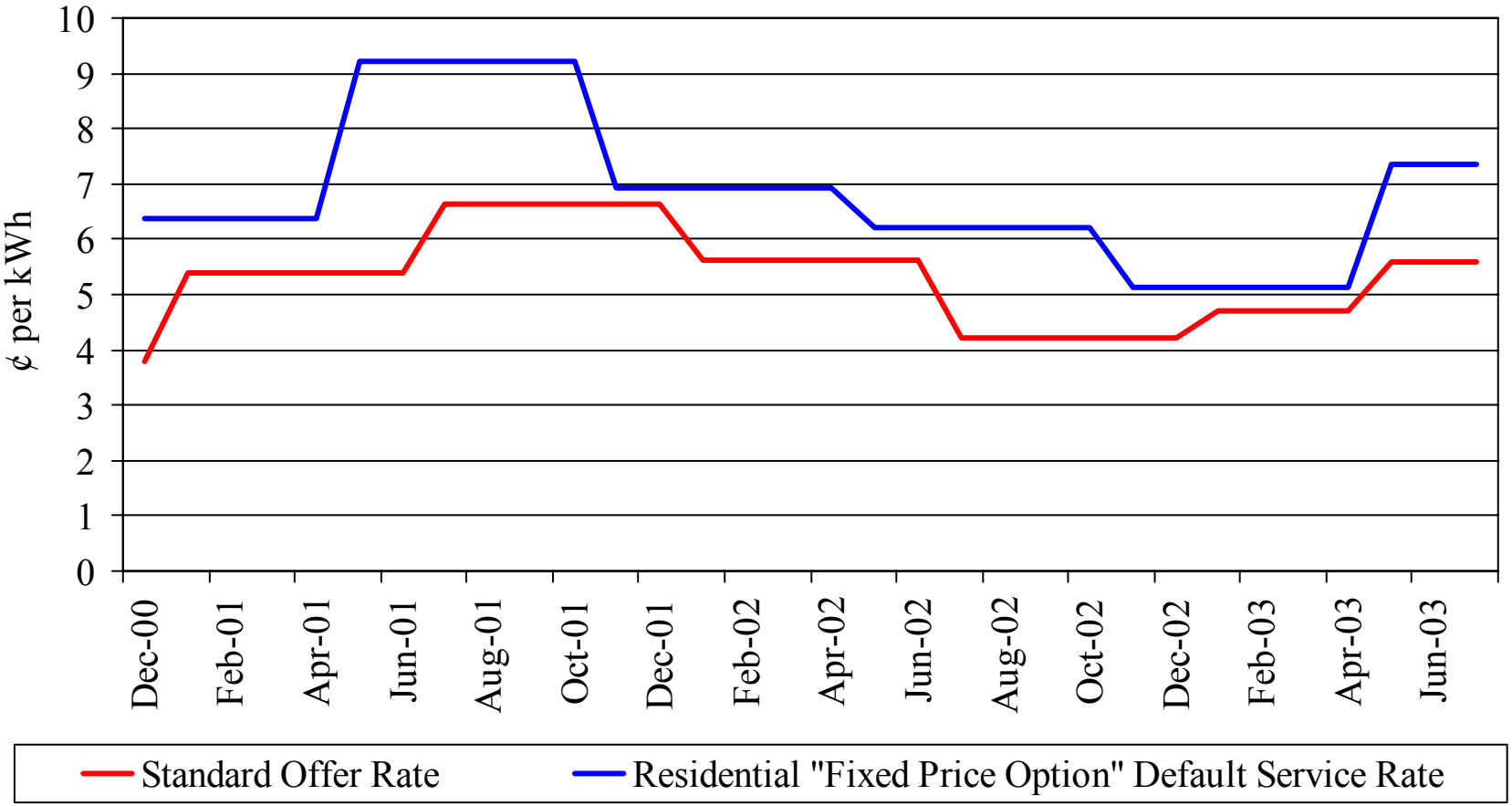
Thank you very much for your time and attention to this matter.

Very truly yours,

Amy G. Rabinowitz

cc: Joe Rogers, Office of the Attorney General

Comparison of Residential Default Service Rate and Standard Offer Rate



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